

AW/DM/040

21 September 2006

Andrew MacFaul
Head of Better Regulation
Ofgem
9 Millbank
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Dear Andy

Ofgem Five Year Strategy 2007-2012

I am responding to Sir John Mogg's August open letter on Ofgem's five year strategy. Northern Gas Networks welcomes the implementation of last year's strategy, for example pushing for market liberalisation in Europe and improving the quality of the consultation process. We recognise that there is much work to continue to take forward and the remainder of this letter answers the three questions raised in your letter, focusing on gas related issues.

1. Key challenges facing the industry

Security of supply remains a critical issue. A severe winter in 2005/06 could have resulted in gas (and consequently electricity) shortages and, although new infrastructure projects are relieving some constraints, there remain concerns about the forthcoming winter.

Increasing wholesale prices continues to be a concern despite the easing seen in recent weeks. This impacts on customers and has resulted in a less stable and predictable market.

Better regulation will continue to be important to ensure that controls on monopoly companies are adequate but that excessive costs are not imposed.

2. Action the Authority should take

Continuing to work with the European Commission is important to bring about market liberalisation which will help ease gas supply issues in the UK. A competitive market in the UK alone is insufficient to ensure security of supply and thus further progress needs to be made in Europe.

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It is essential to ensure that the climate is right in the UK for adequate investment to manage security of supply issues. This means providing sufficient allowances for companies to invest in their networks and that this investment is appropriately incentivised. Furthermore, it is important to ensure that companies are able to finance these investments and that the returns on investment are sufficient to attract investors to network utilities and to encourage companies to invest. Investors also require a stable and predictable regulatory environment. In this regard, disallowance of significant elements of efficiently incurred expenditure that have been undertaken to benefit customers, such as responding to requests for connections, will inevitably increase the perception of regulatory risk and hence the cost of capital that companies incur.

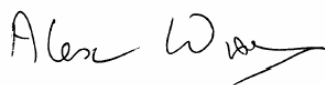
NGN is pleased to note the substantial progress the Authority has made in easing the regulatory burden on supply companies by removing many licence obligations. This work should continue for network companies. In particular, the gas distribution licence was developed for expediency during the sale process and there are a number of conditions (for example, requirements for system management principles statements) that are much less relevant for GDNs than for the NTS and where the conditions could be greatly simplified or removed with no implications for customers. Similarly, the metering of last resort obligation is now unnecessary given the development of competition. All these conditions impose burdens on companies that ultimately fall on customers.

3. Priority areas

A key area of work for the Authority in the forthcoming year will be the GDN price review. Ofgem's intention to develop a clear, predictable approach to the price reviews and hence ensure a stable framework for long-term decision making is appropriate and we look forward to the current GDN price review clarifying the framework through to 2013 and beyond.

The focus of effort on better regulation is welcome and NGN would like to see the Authority continue to focus on projects that add clear benefits to customers, either directly or by reducing obligations on companies that will provide benefits to be passed on to customers.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Alex Wiseman', with a stylized flourish at the end.

Alex Wiseman
Regulation Director

Cc Sir John Mogg, Chairman, GEMA